RECENT AMERICAN DECISIONS.

United States District Court, Eastern District of New York, In Bankruptcy.

IN THE MATTER OF FRANCIS SCHNEPF, A BANKRUPT.

The lien of a levy made by a judgment-creditor under an execution from a state court, is not disturbed by the debtor's filing a petition in bankruptcy.

The Court of Bankruptcy, in such case, may either allow the creditor to proceed with the execution, or may enjoin him and direct the assignee to take possession and sell the goods, with leave to the creditor to apply for an order directing the payment of his judgment out of the proceeds.

THIS was a motion to dissolve an injunction restraining creditors from proceeding to sell personal property levied upon prior to commencement of proceedings in bankruptcy. The bankrupt filed his papers on the 9th of October, and was declared a bankrupt, and procured an injunction prohibiting creditors, Cammeyer & Mason, from enforcing a levy, which the sheriff had made upon Schnepf's property under a judgment against him which they had obtained in a state court. The affidavits on behalf of the bankrupt, showed that he had prepared his papers to take the benefit of the act in September; that the summons in the suit of Cammeyer & Mason was served on him on September 17th, that after that service he sent to them showing them the state of his affairs, and offering them a compromise of their debt, at forty cents on the dollar, telling them that he should go into bankruptcy, if they did not take it; then on the 8th of October, he sent again to them, and they requested till the next day to consider it, and gave him to understand that they would not proceed in their suit in the mean time, but on that afternoon entered judgment against him by default, and issued execution, on which the sheriff made the levy that night, and he filed his papers the next morning.

Daly, for motion.

Knowlton & Baker, contrà.

The opinion of the court was delivered by

BENEDICT, J.—This is a motion in behalf of a judgment-creditor of a bankrupt, to dissolve an injunction heretofore issued by this court, restraining him from proceeding to sell, under an execution, certain personal property levied upon prior to the filing

of the petition in bankruptcy. The motion is opposed by the bankrupt on the ground that the judgment under which the judgment-creditor seeks to proceed, was obtained in fraud of the Bankrupt Act, and by the assignee in bankruptcy, on the ground that the title of the property in question has vested in him as an officer of the court, and no person can be permitted to dispose of or interfere with it except under the order of the Bankrupt Court, to which the property has been transferred by operation of law.

The facts attending the judgment are so fully spread out in the papers before me, and are so simple in their character, that I can without injustice dispose of the question as to the validity of the judgment on the affidavits alone. Upon that question I should gladly hold in favor of the bankrupt if I could do so, as I by no means approve of the manner in which the judgment was obtained, but I do not see how the judgment can be held fraudulent upon the facts. It was obtained in the regular course of judicial proceedings instituted adversely to the debtor, and without collusion. It was entered for an amount admitted to be justly due, and the entry was made as it was, not with the assent of the debtor, but in spite of him. It is in law a valid judgment obtained without fraud or collusion, and can in no proper sense be said to have been procured by the bankrupt with a view to give a preference. This being so, the judgment-creditor, by his levy made prior to the filing of the bankrupt's petition, acquired a security for his debt in the property levied on.

The next question arising is, whether such a security is invalidated by the provisions of the Bankrupt Act, and upon this question I have heretofore had occasion to express an opinion which I see no reason to modify. It seems to me that such a security is preserved, and entitled to be protected upon general principles of law, and that the general scope of the Bankrupt Act indicates that such was the intention of the framers of the act: *Parker* v. *Muggridge*, 2 Story, p. 343.

The remaining question then is, as to the manner in which this right of the judgment-creditor shall be protected. Two methods are open, by either of which the debt will be secured: one is to allow him to proceed to sell the property at sheriff's sale, in which case, as the affidavits show, there will be little or no surplus for the other creditors; the other to direct the assignee in bankruptcy to take possession of and sell the property at private sale, in

which case, as also appears by the affidavits, a sum can be realized not only sufficient to pay the judgment, but to leave a considerable sum for the other creditors. As between these two methods upon such a state of facts, it cannot be doubted that it is the duty of the Bankrupt Court,—charged as it is with the interests of all the creditors,—to prevent the sacrifice of this property by a sheriff's sale, and direct a sale by the assignee, provided the power so to do has been conferred by the act.

A discussion of this question of the power of the court in the premises is rendered unnecessary in this case, inasmuch as the power is conceded to exist by the judgment-creditor, and no objection is made to a disposal of the property by the assignee instead of the sheriff. I postpone, therefore, the discussion of that point until a case shall arise where it is argued, with the remark that such a power seems necessary to a proper administration of the Bankrupt Law, and that it would seem to be fairly included in the power conferred by the act to collect all the assets of the bankrupt, to ascertain and liquidate all liens or other specific claims thereon—to adjust priorities, and marshal and dispose of the different funds and assets, so as to secure the rights of all persons, and the due distribution of the assets among all the creditors.

The motion to dissolve the injunction will therefore be denied, and an order entered directing the assignee to take possession of the property levied upon and sell the same without delay and to the best advantage, with liberty to the judgment-creditors, immediately upon such sale, to apply for an order directing the payments of their judgment out of the proceeds of such sale.

One of the most interesting questions arising under the Bankrupt Law, is as to the power of the Bankruptcy Court to interfere with a judgment which has been obtained by collusion against a party prior to his filing a petition in bankruptcy, where there has been an execution issued and levy made. Ought the Bankruptcy Court to refer the matter back to the original forum? It has been held by some bankruptcy courts, that if a final judgment is regular these courts cannot interfere. Suppose fraud is shown in obtaining it, can the court then give redress? or must the assignee seek his remedy in the other forum? In the case of *Hugh Campbell, a Bankrupt*, ante p. 100 (Western District of Pennsylvania), which was upon a creditor's petition to declare C. a bankrupt, valid judgments had been obtained and entered in the Court of Common Pleas prior to the Bankrupt Law. A sale had been made, and the sheriff had brought the proceeds in court. An injunction issued restraining plaintiff from proceeding further, with leave to move to dissolve. McCandless, J., concluded, "after much reflection," that the court had not the right to sustain the injunction. It was contended that

Congress, by implication, conferred on the District Courts authority to suspend proceedings elsewhere, and to command obedience to their mandates exclusive of other jurisdictions. "By virtue of the 5th clause of the 8th section of the 1st article of the Constitution of the United States (says the Court), granting the power to establish uniform laws on the subject of bankruptcy throughout the United States, Congress had the right to do, but they have not done so." *In the Matter of Burns*, a voluntary Bankrupt (in the same court), ante, p. 105, a petition was filed 31st July 1867. The First National Bank, a creditor of the firm of which B. was partner, on the 18th July 1867, obtained judgment, and made levy prior to the commencement of bankruptcy proceedings. It was alleged that the note on which this judgment was obtained was given under promise not to sue a writ of execution, but to be held as security to afford the firm an opportunity to make some arrangement with their creditors. In violation of this agreement as alleged, and in fraud of the 38th section, judgment was taken and levy made. But before the date fixed by the sheriff to sell, the court granted an injunction staying the sheriff from proceeding, directing him to deliver the property to assignee in bankruptcy. Counsel for the bankrupt argued, that the court was bound to interfere by injunction because the judgment *was not valid*. McCandless, J., said: "If it is fraudulent or *void* under the bankrupt law it is the province of the assignee in bankruptcy, who stands in the attitude of a defendant, to see in *that* forum that no injustice is done to the general creditors," and referred it to the state court. Thus the judge held, even if the judgment was obtained by fraud on the act, that the bankruptcy court *could not interfere*, and the assignee must seek his remedy in the state court. Is this opinion the true rule, and in such a case cannot the bankruptcy court give a remedy? Does not fraud vitiate all contracts and proceedings, and if a judgment be obtained through fraud on the bankrupt law—being void *ab initio*—must the bankruptcy court send the assignee to the other forum? Should not this court examine into the question, and thus save circuity of action and embarrassment? In the case of *Irving* v. *Hughes*, argued before Grier and Cadwalader, JJ., in the Eastern District of Pennsylvania, post p. 209, it was held, that bankruptcy courts have no supervisory jurisdictions over proceedings of the state courts: Act March 2d 1793. But the litigant in it may be restrained from doing what would frustrate or directly impede the jurisdiction expressly conferred by the bankruptcy act: 7 Howard 612; 4 Cranch 179. The bankruptcy court ought to have the power to act in such cases. And have they not? The judge, in *Campbell's Case*, says: "The bankrupt law confers no authority on this court to restrain proceedings therein (*i. e.*, in state courts) by injunction or other process." The court, in the above case of *Francis Schnepf*, did not go so far, nor do we believe any other court has yet taken so broad grounds. But in *Schnepf's Case* the court says: "I should gladly hold in favor of the bankrupt if I could do so, as I by no means approve of the manner in which the judgment was obtained, but I do not see how the judgment can be held fraudulent upon the facts—it was obtained in the regular course of judicial proceedings instituted adversely to the debtor and without collusion." From this ruling it would seem, that had *fraud* been clearly shown, as it was attempted to be shown, the court would doubtless have compelled the judgment-creditor to take *pro rata* with the other creditors. That would seem the wiser course, and in accordance with the spirit of the law.

Thus, in the case of *Metzler and Cowperthwaite* (in the Southern District of New York), reported in 6 Int. Rev. Record, p. 74, BLATCHFORD, J., refused to dissolve an injunction restraining judgment-creditors from proceeding on an execution and levy obtained previous to commencement of bankruptcy proceedings. In the case of *Henry Bernstein* (same court), 6 Int. Rev. Record 222, where there was nothing shown to impeach the *bona fides* of the judgment execution and levy, the sheriff having sold the property levied on, it was *held* the sheriff could apply the proceeds of the property sold towards the discharge of the amount which he is required by the execution to make, and pay the overplus to the assignee, if one, and, if none, then to the clerk of bankruptcy court, to the credit of the bankrupt. But if there had been something shown to impeach the *bona fides*, the court would have ruled otherwise. No lien by a creditor (see § 20), gives him a preference except a lien by mortgage. In the matter of *Benjamin F. Metcalf and Samuel Duncan*, bankrupts, reported in vol. 6 Int. Rev. Record, p. 223, in the Eastern District of New York, which arose upon a petition filed by Buckman, for relief from an injunction issued by the court restraining all proceedings in a cause pending in the Court of Appeals of the state of New York, wherein the petitioner was plaintiff, and one of the bankrupts defendant, the case was tried and judgment given for plaintiff, which was appealed from. One of the securities upon appeal, having become insolvent, the plaintiff, after the commencement of bankruptcy proceedings, gave notice of motion to compel the bankrupt to furnish new security or abandon his appeal, whereupon the bankrupt obtained from this court, in which his petition in bankruptcy had been filed, an injunction staying all proceedings, which injunction the plaintiff in that cause moved to have dismissed. BENEDICT, J., in delivering the opinion of the court, after referring to sec. 21 of the bankrupt act, and stating its object to be to prevent a race of diligence between creditors, and to protect the bankrupt from being harassed with suits pending the question of discharge, says: "My opinion, therefore, is, that it is the clear duty of this court to maintain this injunction heretofore granted against the petitioners until the bankrupt shall have had a reasonable time to obtain his discharge. What effect the discharge, if obtained, will have upon the proceedings pending in the state court I do not undertake to decide. The motion must be denied."

The opinion in this case follows in the wake of the cases of *Bernstein, Schnepf, Metzler and Cowperthwaite*, and others cited, but in effect opposed to the decisions in *Campbell's* and *Burns'* cases.

In the case of *Russel* v. *Cheatam*, 8 S. & M. Rep. 703, it is held, that the state courts must be governed by the construction given to the Bankrupt Act by the Courts of the United States.

And by the case, *Clarke* v. *Rist*, 4 McLean 494, it was held, where creditors are proceeding in a state court to enforce liens on the property of the bankrupt, the Circuit Court would take jurisdiction of a bill for injunction on them *if fraud be alleged.*

The ruling in the cases of *Campbell* and *Burns* seems contrary to the provisions of the 1st section of the Bankrupt Law, which provides among other things, that "the jurisdiction of the court shall extend to all cases and controversies arising between the bankrupt and any creditors, who shall claim any debt or demand under the bankruptcy; to the collection of all the assets of the bankrupt; *to the ascertainment and liquidation of the liens, and other specific claims thereon; to the adjustment of the various priorities and conflicting interests of all*

parties, and to all acts, matters and things to be done under and in virtue of the bankruptcy." Also (sect. 15) provides, that the assignee shall demand and receive from all persons holding the same the estate assigned or *intended to be assigned*. Can it be contended in view of these express provisions that goods levied on, after a judgment has been obtained by fraud, are not one of the estates intended to be assigned? Statutes are to be construed liberally in furtherance of the general object, both with reference to the act itself and the remedy: *Beekman* v. *Wilson*, 9 Met. 438.

We conceive the intent and genius of the Bankrupt Law to be, to give an equitable and just division—*ex æquo et bono*—of the bankrupt's property to all interested that they take a *pro rata* share. Hence, the law provides (sect. 39) against *all* schemes for giving preference by or against a person who is in fact insolvent, and makes any such attempt an act of bankruptcy. Cases will soon arise which will present the question, whether in a case where judgments are obtained by fraud the Bankruptcy Court can interfere squarely before them. J. F. B.[1]

Circuit Court of the United States. Eastern District of Pennsylvania. In Equity. October Session, 1867.

JAMES IRVING *v.* THOMAS HUGHES.

In a case of involuntary bankruptcy in which the debtor, being insolvent, or, having insolvency in contemplation, and intending to give a preference, or to defeat or delay the operation of the Bankrupt Law, has, within six months before the commencement of the proceedings in bankruptcy, given to a creditor who had reasonable cause to believe that a fraud on this law was intended, or that the debtor was insolvent, a warrant of attorney under which judgment has been confessed in a state court, and an execution has been levied upon his stock in trade, which has not as yet been sold under it, the present Bankrupt Law gives to the courts of the United States for the proper judicial district, jurisdiction to prohibit such creditor, by injunction, from proceeding further under such execution.

The District Court, instead of issuing such an injunction under the summary jurisdiction in bankruptcy, may refuse to consider the subject unless under a distinct auxiliary proceeding in equity against such a creditor. The bill at the suit of the petitioning or any intervening creditor, may then be prosecuted in the Circuit Court on behalf of the general body of creditors, until the assignment in bankruptcy, after which the assignee may be substituted or added as a complainant; and if the proceedings in bankruptcy are duly prosecuted, a preliminary injunction issued by the Circuit Court may, in a proper case, be continued after answer, under such conditions as will preserve the priority of the creditor thus restrained if the lien of his execution should ultimately be established.

THIS was a bill in equity, under sect. 2 of the Bankrupt Act,

---

[1] In giving place to the foregoing note by an esteemed contributor, we desire to repeat that we do not commit the Law Register to any particular line of opinion, but hold its pages open to any well-stated view of any professional topic.—ED. A. L. R.